

VZCZCXRO5469
RR RUEHGH RUEHVC
DE RUEHCN #0088/01 0950638
ZNR UUUUU ZZH
R 050638Z APR 07
FM AMCONSUL CHENGDU
TO RUEHC/SECSTATE WASHDC 2427
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHCN/AMCONSUL CHENGDU 2944

UNCLAS SECTION 01 OF 03 CHENGDU 000088

SIPDIS

SENSITIVE
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STATE FOR EAP/CM AND EB
TREASURY FOR TAIYA SMITH

E.O. 12958: N/A
TAGS: [ECON](#) [EAGR](#) [EFIN](#) [KIPR](#) [PGOV](#) [SENV](#) [CH](#)
SUBJECT: SED ENVOY HOLMER SEES WESTERN CHINA'S DEVELOPMENT
CHALLENGES

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1.(SBU) Summary. Treasury Department Special Envoy to the Strategic Economic Dialogue (SED) Ambassador Alan Holmer visited the western China cities of Xi'an and Chengdu from March 3 through March 6. Visits to nearby rural communities in both provinces underscored how poverty alleviation projects can only go so far in improving living standards: most obvious wealth in such communities comes from residents securing non-rural income by obtaining work in nearby urban areas or in China's coastal provinces, enriched by the manufacturing of goods destined for foreign markets. End summary.

2.(SBU) Ambassador Holmer, accompanied by Deputy Chief of Staff Taiya Smith, U.S. Embassy Beijing Minister-Counselor for Financial Affairs David Loevinger, and Beijing Econoff David Meale visited Xi'an on March 3-4, and Chengdu on March 4-6. Also accompanying Ambassador Holmer were three Beijing-based officials from the Ministry of Finance.

EXPOSURE TO VILLAGE LIFE IN XIAN

3.(SBU) Vice Governor Zhao Zhengyong expressed appreciation to Ambassador Holmer that Shaanxi Province was his first stop in China outside of Beijing. Zhao reviewed for an extended period of time a wide array of publicly available data about the province and then discussed tourism development, emphasizing local pride in Shaanxi's cultural offerings. Zhao also underscored the importance to Shaanxi of its extensive network of correspondent relationships with provinces and states throughout the world, including Minnesota in the U.S. Holmer saw first-hand the commercial links between Shaanxi and the United States when he visited a Janssen pharmaceutical plant the following day (Janssen is a Belgian subsidiary of Johnson & Johnson).

4.(SBU) To further understand Shaanxi's rural challenges, Ambassador Holmer visited the village of Gongwang, approximately 90 minutes from the center of Xi'an. Local officials representing the village, township, and county levels told him that 308 of the village's 1,027 residents could be classified as impoverished, but that overall living standards were on the rise. The fundamental impediment to poverty alleviation, they said, is a shortage of arable land. Shaanxi's per-capita farming area is 0.7 mu, less than one-eighth of an acre. Holmer's interlocutors observed that living standards are far worse in the nearby mountainous areas, which cover the majority of Shaanxi Province. Central Government policies supporting

higher-value agriculture, along with subsidies for school fees and expanded rural medical care, are all positive factors in improving lifestyles. All that said, one participant pointed out that even though there are now in theory an adequate number of teachers for Gongwang's students, there are absenteeism issues among them, reflecting their chronic health problems.

5.(SBU) Ambassador Holmer walked through Gongwang, talking at random to villagers, with questions focusing on how outside employment is boosting their incomes. Many villagers, he learned, seek part-time work in nearby urban areas when time permits. It was clear that the phenomenon of "surplus labor" migrating to coastal areas is not widespread in this part of Shaanxi. However, in one dramatic case, a 24-year-old cook who had been working in Hangzhou (Zhejiang Province) proudly showed Holmer the new house he was building next door to the dilapidated home occupied by his parents. He said the opportunity to work in Hangzhou had not only improved the life of his family in Gongwang, but had also given him sufficient status to ask (and receive) permission from his fiancée's father to marry his daughter, a success that had come his way just the previous day.

THE RABBIT KING AND HIS COURT

16. (U) In a rural area outside of the small western Sichuan town of Dayi, Ambassador Holmer visited farmers who had benefited from a poverty alleviation project managed by the NGO Heifer Project International (HPI). Thanks to HPI's initiative, the farmers in and around Dayi are now raising substantial numbers of rabbits, and earning badly needed cash as a result. An HPI representative said that there are now 17,000 beneficiary families in and around Dayi, and 1.8 million rabbits are raised there every year.

7.(U) After touring the farmer's houses and visiting the rabbit

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raising pens, Ambassador Holmer met with a group of farmers, many of whom had traveled substantial distances to see him. A typical story was that of a young woman named Zhang Mingshan, who said that the 500 rabbits she had raised and sold to a nearby processing plant in 2006 earned her RMB 3500 (USD 450) in net profit.

8.(U) Ambassador Holmer then met with Ren Xuping, who has become famous as the "Rabbit King" due to the size of his rabbit rearing operation and his media prominence. Ren gave the Ambassador a tour of his operation, which covers 70 mu (8.4 acres), and includes pens holding many thousands of rabbits. Ren emphasized that he planned to expand his sales of rabbit meat overseas, and noted the European Union appeared to be a particularly lucrative market. At the same time, he emphasized his concern for his neighbors and his desire to see them participate in the benefits of his expansion. He also claimed he had donated breeding rabbits to North Korea and Nepal, hoping to contribute to the alleviation of poverty in those countries.

9.(SBU) Asked about the profitability of his operation, Ren claimed that in 2006 he had made RMB 50 million (USD 6.4 million) in gross profit, and RMB 4 million (USD 513,000) in net profit. He stated he paid no taxes on most of his operation, since it had been classified as a poverty alleviation project, but he had to pay a value added tax on the processing stage in which rabbit meat was turned into sausage. Ren stated 80 percent of his profits were reinvested into his operation, with ten percent held as a capital reserve, and another ten percent going to HPI's poverty alleviation center.

10.(SBU) Asked for his opinion on the area's greatest development needs, Ren mentioned transportation infrastructure and environmental protection as most pressing. In response to an inquiry about the quality of the area's drinking water, a local official claimed there was a major rural area drinking

water safety project underway, and he expected 100 percent of the area's rural population to receive potable water within the next four years. The project supposedly requires an investment of RMB 10 million (USD 1.28 million) per year.

IRRIGATION AND HEALTH CARE

11.(SBU) Provincial officials took Ambassador Holmer on a tour of the ancient Dujiangyan irrigation project, which has been developed into a major tourist destination. Afterwards, the delegation visited the Zhongxing Township Hospital, a relatively large and clean facility specializing in delivering health care to rural residents. The doctor leading the tour said the hospital employed 40 doctors and 57 nurses, and claimed he had never heard of any AIDS cases coming through the facility. After a brief look at the traditional Chinese medicine clinic, the Ambassador toured the remainder of the facility. One clinic was labeled "family planning," and when the Ambassador asked about the frequency of abortions, the doctor responded (improbably) that the hospital performed "very few," relying instead on birth control education.

PROVINCIAL LEADERSHIP

12.(U) The Ambassador participated in a courtesy visit and an official banquet hosted by Sichuan Provincial Vice Governor Wang Huaichen, whose portfolio includes tourism and statistics. Wang noted Sichuan had lagged behind other areas of China in attracting FDI, and claimed the province's rough terrain contributed to uneven development patterns. While he expressed concern over the province's urban-rural income gap, he insisted the province provided an excellent environment for foreign investment.

13.(U) The next day, the delegation met with Sichuan Great Western Development Office Director Mr. Yang Shizuo, who outlined the basics of China's Great Western Development Initiative (GWDI), which he said applied to 71 percent of China's territory. Critical elements of the GWDI, according to Yang, were the need to increase cash income in rural areas, greater attention to energy generation (especially hydropower and natural gas development), and improvement of the area's transportation infrastructure. To accomplish these and other GWDI objectives, Yang listed seven goals: (1) reconstruction of rural villages; (2) greater assistance to migrant workers; (3) improvement of village-level education, and especially

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vocational training; (4) greater attention to public health issues; (5) an increase in the quantity and quality of social services; (6) an increase in FDI; and (7) increased construction of roads and highways.

14.(SBU) Ambassador Holmer raised several important points with Yang, including the need to improve the area's climate for FDI. Most basic was the need to improve rule of law, including better dispute resolution and increased protection for IPR. Customs clearance procedures needed to be made more "customer friendly." Business community concerns such as better international schools and western-style health care were also important. And of course, the SED itself was aimed at opening China's financial markets, while civil air negotiations could help the province in its efforts to improve transportation links. Finatt Loevinger also mentioned the desirability of exchange rate reform, which would remove distortions in China's investment climate, and ultimately bring more FDI to China's western areas.

THE AMERICAN BUSINESS COMMUNITY HAS ITS SAY

15.(SBU) At a lunchtime meeting with local representatives of

U.S. businesses (mostly SMEs) hosted by Sichuan AmCham, the Ambassador discussed the purposes and accomplishments of the SED, and detailed the points he had made during his trip west on issues such as rule of law, logistics and customs clearance procedures, and governmental transparency. Attendees spoke frankly about the challenges of doing business as SMEs in China's western areas. In addition to subjects such as customs procedures, transparency, and lack of high-quality international schools, several attendees complained of difficulties encountered in hiring qualified staff. Another common concern was China's corporate income tax structure, and especially the post facto cancellation of a three percent discount in the rate applied to Foreign Invested Enterprises (FIEs). Later, the Ambassador toured Intel's assembly and packing facility just outside Chengdu, which at USD 450 million is the largest U.S.-invested project in Sichuan.

COMMENT

16.(SBU) Although many of the rural areas visited had no doubt been carefully prepared by local authorities in advance of the delegation's visit, the contrast with China's (relatively) wealthy coastal areas remained striking. As the delegation stressed to local officials, these contrasts to a great extent reflect distortions caused by Central Government policies. The absence of open financial markets and the consequences of an inflexible exchange rate system are not Beijing issues alone.

17.(U) This cable has been coordinated with Embassy Beijing, and has been cleared by Ambassador Holmer.
BOUGHNER